

MINUTES

BUDGET & FINANCE COMMITTEE

December 9, 2015

A meeting of the Budget & Finance Committee of the Council of the County of Kaua'i, State of Hawai'i, was called to order by Arryl Kaneshiro, Chair, at the Council Chambers, 4396 Rice Street, Suite 201, Lihu'e, Kaua'i, on Wednesday, December 9, 2015, at 9:48 a.m., after which the following Members answered the call of the roll:

Honorable Mason K. Chock
Honorable Ross Kagawa
Honorable KipuKai Kualii
Honorable Mel Rapozo
Honorable JoAnn A. Yukimura
Honorable Arryl Kaneshiro

Excused: Honorable Gary L. Hooser

Minutes of the November 12, 2015 Budget & Finance Committee Meeting.

Upon motion duly made by Councilmember Chock, seconded by Council Chair Rapozo, and carried by a vote of 6:0:1 (*Councilmember Hooser was excused*), the Minutes of the November 12, 2015 Budget & Finance Committee Meeting was approved.

The Committee proceeded on its agenda items, as shown in the following Committee Reports, which are incorporated herein by reference:

CR-BF 2015-39: on Bill No. 2602	A BILL FOR AN ORDINANCE AMENDING ORDINANCE NO. B-2015-796, AS AMENDED, RELATING TO THE OPERATING BUDGET OF THE COUNTY OF KAUA'I, STATE OF HAWAI'I, FOR THE FISCAL YEAR JULY 1, 2015 THROUGH JUNE 30, 2016, BY REVISING THE AMOUNTS ESTIMATED IN THE CRIMINAL ASSETS FORFEITURE FUND (<i>Kaua'i Police Department, KPAL Youth Center/Interim KPD Training Facility – \$300,000.00 (Operating Budget)</i>) (Approved.)
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(Note: The Committee was in recess from 10:34 a.m. to 10:50 a.m., during discussion on Bill No. 2606.)

CR-BF 2015-40: on Bill No. 2603

A BILL FOR AN ORDINANCE AMENDING ORDINANCE NO. B-2015-797, AS AMENDED, RELATING TO THE CAPITAL BUDGET OF THE COUNTY OF KAUAI, STATE OF HAWAII, FOR THE FISCAL YEAR JULY 1, 2015 THROUGH JUNE 30, 2016, BY REVISING THE AMOUNTS ESTIMATED IN THE GENERAL FUND CIP (*Kauai Police Department, KPAL Youth Center/Interim KPD Training Facility - \$300,000.00 (CIP Budget)*) **(Approved.)**

CR-BF 2015-41: on Bill No. 2605

A BILL FOR AN ORDINANCE AMENDING ORDINANCE NO. B-2015-797, AS AMENDED, RELATING TO THE CAPITAL BUDGET OF THE COUNTY OF KAUAI, STATE OF HAWAII, FOR THE FISCAL YEAR JULY 1, 2015 THROUGH JUNE 30, 2016, BY REVISING THE AMOUNTS ESTIMATED IN THE DEVELOPMENT FUND CIP (*Coco Palms Resort Development Use Permit Conditions - \$110,000.00*) **(Approved.)**

Bill No. 2606

A BILL FOR AN ORDINANCE AMENDING CHAPTER 5A, ARTICLE 9, KAUAI COUNTY CODE 1987, AS AMENDED, BY ADDING A NEW SECTION 5A-9.3, RELATING TO A HOMESTEAD TAX CAP FOR HOME EXEMPTION AND LONG TERM AFFORDABLE RENTAL PROPERTIES **(This item was Deferred.)**

Council Chair Rapozo moved for approval of Bill No. 2606, seconded by Councilmember Kualii.

Committee Chair Kaneshiro: I believe the Administration has a presentation for us.

There being no objections, the rules were suspended.

STEVEN A. HUNT, Real Property Tax Manager: I am here today wearing several other hats, including a member of the budget team, as well as a member of the long-term financial strategy team, and the vacancy review team – all of which have budget implications. The reintroduction of the Homeowner Tax Cap is something that has significant finance impacts or could. Before getting into the cap itself and some of the language of the cap, I just wanted to go back and give a little bit of history of taxation and how the Counties had inherited this from the State and the changes that have been done over time.

(Mr. Hunt provided a PowerPoint presentation which is attached hereto and incorporated herein as Attachment #1.)

The transfer of Real Property function from State to County was completed in 1982. It was part of the Constitutional Conventions (ConCon) back from 1977. In 1981 which was the last year the State ran the real property tax functions, the tax

rate was fourteen dollars and fifty cents (\$14.50) for all property classes and that was based on sixty percent (60%) of fair market value. To equate that in today's dollars, it would be a uniformed tax rate across all eight (8) categories at eight dollars and seventy cents (\$8.70). When the real property assessment was transferred to the Counties, the legislature prohibited the Counties from making ordinance changes for ten (10) years. I am reading back some of the Committee Meeting minutes and it reflects that there were concerns about giving the authority to the Counties to change law and that there may be some special interest groups that would benefit from giving that authority to the Counties.

In 1991, the Homestead tax class was created. Since that time, Chapter 5A, which is the Real Property section has had sixty-eight (68) ordinance changes. Listed here are the years and the ordinance changes that occurred in each of those years.

Tax rates have also changed over time. Again, as I referred to in 1981, we had a single-unified rate of fourteen dollars and fifty cents (\$14.50) for all categories, both land and building. In 1982, the Hotel & Resort was increased from fourteen dollars and fifty cents (\$14.50) to fifteen dollars and ninety cents (\$15.90) for the land and improvements. There were decreases to the improvements for the rates on Residential, Commercial, and Agricultural which went from fourteen dollars fifty cents (\$14.50) to thirteen dollars and seventy-five cents (\$13.75).

In 1983, rates were changed again. A rate of eight dollars and seventy cents (\$8.70) for Land and eight dollars and twenty-five cents (\$8.25) for Improvements for seven (7) of the eight (8) classes. This essentially reflects the conversion because this was the year that we converted from sixty percent (60%) for market value on the assessments to a hundred percent (100%). However, the Single-Family Residential was reduced to seven dollars and seventy cents (\$7.70) for Land and seven dollars and sixty-six cents (\$7.66) for Improvements.

In 1984, the Single-Family Residential rate was changed again. It went to six dollars and forty-five cents (\$6.45) for the Land and five dollars and eighty-one cents (\$5.81) for the Improvements, and all other tax classes stayed at the eight dollars and seventy cents (\$8.70).

1991 was the year that the Homestead tax class was first created and we set rates at that point at four dollars and four cents (\$4.04) for the Land and three dollars and eighteen cents (\$3.18) for the Improvements.

Primarily there were some changes up and down to the eight (8) classes between the periods of 1991 and 2013, until we had a major change, which became the unified rate. We no longer have a Land and Building rates, but a single rate for Land and Improvements together. Now properties are classified based on use rather than zoning and the Homestead rate was reduced to three dollars and five cents (\$3.05) in 2013.

In 2015, which is the Fiscal Year 2016, we now have ten (10) classification of property with large rate spreads ranging from three dollars and five cents (\$3.05) to ten dollars and eighty-five cents (\$10.85). We created a Commercialized Home Use class for owner-occupied properties that are not exclusively used as their primary residences. Just a little background on where we have come.

The Permanent Home Use Tax Cap. Why was the Permanent Tax Cap removed? Again, this was a collaborative effort with both the Administration and the Council at that time. The cap was never intended to be a permanent solution, but rather a temporary measure to allow tax reform proposals to be implemented. As you

recall there were two (2) major comprehensive tax proposals. One was implemented or sent up by the Real Property Tax Task Force, I believed that was in 2004, and then in 2008. The real property initiative which came from the Administration, which was also sent to Council. Many elements of those proposals have been adopted over time, which represents some of those sixty-eight (68) ordinance changes, but the comprehensive plan was never adopted at the inception when it was submitted. Another reason was we needed to return to a more simplistic and understandable property tax system where taxes were once again related to property values. And we wanted to assure equity and fairness amongst taxpayers of a similar class, while providing sufficient income-based relief measures for those that have limited means.

How does Hawai'i rank in terms of property tax rates? Based on a study done by the Tax Foundation, Hawai'i is last. We have an effective tax rate of two dollars and eighty cents (\$2.80) across the State. Kaua'i, specifically for the Homestead class, has an effective tax rate of about two dollars and twenty cents (\$2.20) and for Commercial Home Use, which are also owner-occupants with income properties, about three dollars and fifty cents (\$3.50) as an effective rate. However, as you are aware Hawai'i also has the highest values; the median values, and this is based on a 2009 study, was five hundred and seventeen thousand and six hundred (\$517,600). When you combine the highest assessments with the lowest tax rates, Hawai'i ranks thirty-fourth (34th) overall in terms of the median tax paid by homeowners at thirteen hundred and twenty-four dollars (\$1,324). Hawai'i did have the sixth (6th) highest household income, and property taxes as a percentage of income ranked Hawai'i forty-first (41st) out of fifth (50th) with a median tax being approximately at one point sixty-two percent (1.62%) of household income.

What are the common economic criteria for evaluating tax systems? Again, we have not had our workshop yet, but I think these are things that are important to consider: growth, stability, simplicity, neutrality, and equity. Growth refers to – Does revenue raised by the tax grow along with the economy or the program responsibilities it is expected to fund? Stability – Is the revenue raised by the tax relatively stable over time? Simplicity – Is the tax simply and inexpensive for taxpayers to pay and for government to collect? Neutrality – Does the tax have little or no impact on people's decisions about how much to buy, sell, and invest? Equity – Do taxpayers with similar incomes pay similar amounts and do tax liabilities rise with income?

Under the cap, I am going to be addressing these individually. Growth, having capped taxes on nearly one-third (1/3) or about thirty-six point eight percent (36.8%) of Kaua'i's gross valuation base that is solely affixed to the Consumer Price Index Urban (CPI-U) of Honolulu could severely limit the ability to meet obligations if or when expenses outpace this index. If the cost of employee wages, through collective bargaining, health care premiums, potential County lawsuits, insurance premiums, road paving, existing and future debt service, solid waste disposal, recycling, transportation, gasoline, and electricity; if any of these do not parallel the CPI-U of Honolulu, then the additional costs which will be added to the budget, will be borne by the non-homeowners tax classes.

Growth continues. Property values generally increase as the economy grows, but they are not always proportionate to one another. Property values are affected by supply and demand, interest rates, and outside investment. Therefore, real estate values may rise and fall faster than other economic indicators.

Similarly, the programs and responsibilities that property taxes are funding do not always rise and fall with economic indicators. The County cannot simply layoff civil servant employees when the economy dips, as there are contractual agreements

that must be honored. Under this proposed cap model, growth is limited to CPI-U unless these properties sell and the cap is reset, or we have additional growth in inventory. Municipalities using capped systems tend to see increased fees and other taxes, such as the Community Facility Districts or Mello-Roos, and service fees to offset periods when tax revenues are insufficient.

I have included a graph of what has happened to the relative percentage of property taxes to those areas that began capping taxes early on. As you can see in California in 1977, property taxes used to represent about sixty-six percent (66%) of the tax base, while today is only forty percent (40%) because of Proposition 13, but you can see other charges that used to be fifteen percent (15%) in 1977, now at thirty-five percent (35%) of their revenue.

Next is stability. Property values do change year-over-year, and they occasionally do so with significant swings based on market sales. Capping taxes provides homeowners with a certain level of predictability during a rising market; however, it does not provide revenue stability for the County when values are falling. As currently written, the Bill only provides homeowners with stability not the County of Kaua'i – it is a ceiling, not a floor.

Under this proposed Bill, if assessed values decline and the market taxes, which is the net taxable value times the market tax rate, fall below the capped taxes, the actual taxes are lowered and a new ceiling is reset. This severely impacts the County's ability to restore revenue during the recovery period.

Simplicity. While on the surface it may seem straightforward enough, take it from experience, ten (10) years worth of dealing with the permanent home use cap, the tax cap is a highly complicated program to understand and implement. Aside from having to explain to taxpayers, lenders, and other interested parties how the taxes were calculated, there are other tax adjustments that need to be accounted for such as, additional construction, renovations, changes in exemptions, changes in tax classification, and land area changes such as subdivisions, consolidations, and CPRs. Consider that property values rarely remain the same over time. The percentage of time that real property assessment (RPA) staff spent solely on the permanent home use (PHU) cap when it was implemented, relating to issues was about thirty percent (30%) to thirty-five percent (35%). This significantly reduced the amount of time available for picking up new construction, enforcing tax code, analyzing neighborhoods for better market modeling results. Returning to the capped system would require additional budgetary funding. In our initial conversations with our software vendor, they are estimating...if this is intended to be a permanent solution and should be programed; it may be in excess of one hundred thousand dollars (\$100,000) in programing. Based on our experience for implementing this the last time, RPA would request additional staff to help manage issues related to the tax cap that come up. Administering the tax cap is anything but simple.

In dealing with neutrality. Having a tax cap could alter taxpayer behavior over time. For example, longtime homeowners that have accumulated sizable differences between their capped taxes and their market taxes may not be able to downsize without the portability of their property capped taxes. In turn, this not only affects the real estate market by possibly preventing certain inventory from being marketed, but also limits the potential revenue growth, as turnover and the resetting of the cap are key elements to revenue growth under a capped tax model. Tax caps may also discourage investment in owner-occupied properties since the new construction, under this Bill, would be fully taxable.

I think most important is equity. There are two (2) standards of equity – vertical equity and horizontal. Vertical equity occurs when wealthier taxpayers pay a greater amount in taxes than less wealthy taxpayers. Horizontal equity, on the other hand, occurs when similar taxpayers, those with similar incomes or wealth pay the same amount in taxes. When two (2) owners of nearly identical properties pay different amounts of property taxes because one (1) owner bought the property a decade before the other, then no horizontal equity has been achieved. With vertical equity, owners of valuable property would pay more in taxes because owners of valuable property generally are wealthier than owners of less valuable property. The capped tax system can result in owners of more valuable property, actually paying less than owners who recently acquire less valuable property, merely because of the cap. Tax caps do not meet the standards of either vertical or horizontal equity.

Are we doomed to repeat history? Reintroducing the cap may bring back many of the problems that existed, namely: Unequal taxes between homeowners within the same tax class and having similar assessed values. The inability to recover revenue losses when market taxes fall below the prior years capped ceilings. Creates a disproportionate tax burden on other tax classes should the operating cost of government exceed the CPI-U of Honolulu. Given that this would be a revenue cap, it may limit future capital improvement investment in Kaua'i. And it does not allow for timely budget forecasts, as I cannot simply predict what the taxes are without knowing the rates and running what those differences will be.

Finally, it may create future problems. Reintroducing the cap could undermine many of the existing tax reform measures already enacted to minimize the impact of the former cap's removal. It may create a backlash with our state legislators, as County officials have been lobbying for a greater share of the Transient Accommodations Tax (TAT) revenue based on our testimony, the County of Kaua'i has insufficient tax revenues. Limiting the tax revenue could possibly have bond rating implications as the rating agencies look to the ability to generate revenue in their analysis of our rating.

That is my completion of the presentation. I do have some comments on the Bill itself on a technical nature, but I will handle those after you have questions on the presentation.

Committee Chair Kaneshiro: We will take the questions solely on the presentation first, and then we will let Steve mention his comments about the actually Bill itself, and then we can ask questions about his comments also. If there any questions specific to this presentation, let us ask those right now.

Council Chair Rapozo: I have one question on page 9, and I think it is important because I hear this a lot that we pay the lowest property taxes in the Country, but Steve is it not fair to say that all the states are different and that some states are required to fund school districts – I mean counties. Counties are required to fund different things. Was there ever a comparison made that compared apples to apples? Basically, in a municipality like Kaua'i that we fund government and not school districts and everything else; where would we rank?

Mr. Hunt: It would be difficult to say because we would have to look at...and this is a comparison of just homeowner taxes, principle taxes, not the total population. It would be difficult because we would have to look at all other taxes. Some states do not have general excise tax and some tax higher on fuel, some have sales taxes, so you would have to look at the totality of statewide taxes and then somehow distribute between state and county and try to determine how much of that is borne specifically by the homeowners. Therefore, you are right in that

this is only related to property taxes, but property taxes do not necessary fund all the functions of government that other property taxes may fund.

Council Chair Rapozo: Right and if we did a comparison like that with municipalities like Kaua'i that did not fund our...what is funded by the state here is very hard to say that we would be ranked at the last.

Mr. Hunt: Right.

Council Chair Rapozo: I think it is a great slide if you are looking at everything just for discussion, but I think the intent of the slide was to show that we are paying the lowest tax in the state.

Mr. Hunt: We are paying the lowest effective tax rate and we are forty-first (41st) in terms of relative to income and thirty-fourth (34th) relative in total based on value and the rate combined.

Council Chair Rapozo: As I was looking at Taxpolicycenter.org and it basically said...and this was nationally school districts get thirty percent (30%) of the general revenue from property taxes in the jurisdiction that they reside. That is substantial, or it could be.

Mr. Hunt: Yes.

Council Chair Rapozo: Therefore, I am just suggesting that when you look at the numbers...we may not be ranked last...

Mr. Hunt: Correct.

Council Chair Rapozo: ...as far as the effective tax rates.

Mr. Hunt: State's like New Jersey, I think their property taxes which were ranked the highest, I believe they are paying somewhere close to sixty-four hundred dollars (\$6,400) as a homeowner annually. Obviously, those are probably funding a lot of the state functions or that jurisdiction.

Council Chair Rapozo: Thank you.

Committee Chair Kaneshiro: Councilmember Kualii.

Councilmember Kualii: On page 7, you just have the words, "The Permanent Home Use Tax Cap," and then on page 8, you go on to describing it and why it was removed.

Mr. Hunt: Yes.

Councilmember Kualii: The "tax cap was never intended to be a permanent solution, but rather a temporary measure to allow tax reform proposals." In the name itself, "permanent home use tax cap," they sadly used the word, "permanent," which is just to make it confusing, I think, because what they are talking about is a primary home or homestead and owner-occupied. Is that correct?

Mr. Hunt: You are correct. I think I have that somewhere in my notes. It was Ordinance No. 571, I believe, is where it originally came from and this was actually a true dedication program. They called it permanent home use, and Councilmember Yukimura remembers this one, it was a ten (10) year

dedication that you pledge that you were not going to sell your house and you received beneficial treatment and there would be a rollback on taxes if you breached that. That framework was used and the original framework which was a dedication program was used to implement the one that we just cancelled, what we called the permanent home use, although it was a temporary, it used the same framework. Therefore, the nomenclature was still saying permanent, but it really was not meant to and all the legislative intent says that it was meant to be a stop gap to implement many of the other ordinances to reform.

Councilmember Kualii: And then in that bullet, you have "RPTTF & RPI."

Mr. Hunt: Yes.

Councilmember Kualii: What does that mean?

Mr. Hunt: The "RPTTF" stands for Real Property Tax Task Force. That was a committee that was assembled and I think both Council and the Administration has appointed members on that. I chaired that many years ago when I was not with government.

Councilmember Kualii: That went from when to when?

Mr. Hunt: I believe 2004 was when we made the recommendations and the ordinance changes and submitted that to Council.

Councilmember Kualii: Just from 2003 and 2004?

Mr. Hunt: Yes.

Councilmember Kualii: What does "RPI" mean?

Mr. Hunt: "RPI" stands for Real Property Initiative. I was not a participant in that one. That one came from a combination of finance and real property assessment. It was an internal one that they worked on for about eighteen (18) months and then submitted...

Councilmember Kualii: About how long ago was that?

Mr. Hunt: It was submitted in 2008. I believe it was deferred, therefore it is technically still with you.

Councilmember Kualii: I am not sure where you said this, but you said something to the effect of, "We have not gotten there yet or something is coming; a group." Is there going to be a new task force?

Mr. Hunt: I mentioned that there was some request, actually by Council, to participate in a workshop.

Councilmember Kualii: A workshop.

Mr. Hunt: Again, I think it is a little bit cart before the horse because...

Councilmember Kualii: Are you preparing for that workshop?

Mr. Hunt: I would be participating. I am not chairing it nor leading it, but would be a resource person for that.

Councilmember Kualii: When do we anticipate that to happen?

Mr. Hunt: That is in your hands.

Councilmember Kualii: So you are ready to go tomorrow if we schedule it tomorrow?

Mr. Hunt: I would not say tomorrow...I would like to get through the appeal period first and finish up certification role, but somewhere in...

Councilmember Kualii: Mid-January to mid-February, before budget?

Mr. Hunt: Yes, I have some personal travel in mid to late-January, but other than that, I am available.

Councilmember Kualii: Coming soon.

Mr. Hunt: Yes, coming soon. I will make myself available as much as possible.

Councilmember Kualii: Thank you.

Councilmember Kagawa: Steve, you stated on page 22 that we may create a backlash with our State Legislatures as county officials have been lobbying for a greater share of TAT taxes. I did this little sketch here using my friend Google. On a joint family of two based on a hundred thousand dollars (\$100,000), the total federal government taxes, one would pay maybe in the area of twenty-three thousand dollars (\$23,000). The State government based on an income tax rate of ten percent (10%) you are looking at ten thousand plus, I am saying maybe twenty-five thousand dollars (\$25,000) in purchases over a course of a year, would be one thousand dollars (\$1,000). Eleven thousand dollars (\$11,000) to the State, twenty-three thousand dollars (\$23,000) to the Federal government, and if the County government, I am just looking at property taxes and not utilities, we are looking at a value of five hundred thousand dollars (\$500,000), you pay fifteen hundred dollars (\$1,500), and vehicle tax maybe three hundred dollars (\$300) each car. What I am saying is that I do not know what we are trying to worry about or the backlash when the differences between the County, the State, and the Federal government is so minute. Have you folks looked from that perspective when worrying about what the State and the Federal government thinks?

Mr. Hunt: We cannot worry about the Federal government because it does not matter what State you live in, you are going to pay the same Federal government taxes.

Councilmember Kagawa: But do we look at the...

Mr. Hunt: And we do not get an opportunity to take those unfortunately.

Councilmember Kagawa: Do we look at the middle-class family as a whole when we consider what we are going to do with property taxes and when we say, "This is fair," do we look at all of the obligations that a family might have?

Mr. Hunt: My job is to set values. That is really all my job is. The policy calls in terms of rate setting and the distribution, in fact, I think it is in Section 5A-6.3 that actually talks about the Council, "Shall set the rates and they shall look at the assign percentage of each class." Really, that should be at this level where those decisions are made. I obviously get involved with policy because I have some resource and background, but in terms of rate setting or what the appropriate rate should be, or if we end up giving a break to one side if you have a Homestead on one, but they have a second property, they may save on one side and then pay on the other. There are a lot of different considerations to not just what an owner-occupant pays, but what everyone should be paying.

Councilmember Kagawa: I think that is why the proposal was introduced. We are trying to prevent the huge fluctuations in market that seem unpreventable and I think...

Mr. Hunt: I think in a pure system the rate setting should do that. If you see values on the rise and they are rising faster than you believe the cost of government is rising, then you lower the rates the offset. You can determine how much taxes you want to gain from that particular tax category.

Councilmember Kagawa: Would that be unfair if only certain areas went up a lot?

Mr. Hunt: It can be because that is how the market reacts.

Councilmember Kagawa: I think that is the problem with just relying on tax rate because assessments go up in some areas then some.

Mr. Hunt: You could have an overall trend of values going up five percent (5%), but you could have some going up twenty percent (20%) and some dropping ten percent (10%). I mean there are conditions in neighborhoods that may actually still result in lower values.

Councilmember Kagawa: Thank you for your presentation.

Mr. Hunt: You are welcome.

Councilmember Kagawa: Good job.

Councilmember Yukimura: I am just following up of what Councilmember Kagawa has focused on about this backlash with our State Legislatures. It is pretty clear to me and I get their feedback that if we lower our property tax rates for homeowners when they are already relatively low, they are going to say, "Well, that means you do not need revenues. Why are you asking us for TAT moneys?" Even Mayor Arakawa, himself, said, "I apologize because my County has lowered tax rates and I cannot go and ask for the TAT now because they are going to throw it back in our face."

Mr. Hunt: I have heard those same comments and again, one other hat I do wear, I am the representative for Kaua'i on the TAT working group committee. Although this is not the forum for presenting it, I know the proposal that is going forward is very favorable to the Counties. Now whether the Legislature is going to pass that or not is another story.

Councilmember Yukimura: But that is a good first step for us.

Mr. Hunt: It makes it difficult if we are lowering rates here with the anticipation that we are going to get here...when the State is also crying out that they need the tax revenue; it just makes it challenging.

Councilmember Yukimura: Tell us how you feel the existing programs are really addressing the main problem with ever interesting...well actually...excuse me for jumping all around in my mind, but this differential of property tax growth values that we were talking about different parts of the island that will increase in valuation faster than other parts. That is somewhat addressed by the offsets of our program where we are protecting those who are poor or on fixed incomes, right?

Mr. Hunt: There are very targeted approaches. I cannot say that it works for everyone, but we have a number of people that are participating in those now. The very low income, which you pay in lieu of tax three percent (3%) of your gross income. There is preservation which has a higher threshold for your income, you are up to one hundred thousand dollars (\$100,000) in gross income now to participate in that with the criteria that you have lived there for ten (10) years and you are owner-occupant and you in the Homestead class that has worked for some people in some very high valued areas. Then, we have just the basic low-income exemption itself. There are three (3) tiers, two (2) are more credit programs, and one (1) is the exemption. They can always be tweaked and improved on, but I think by in large it is addressing the issue of run up values where they do not have the means to pay. Obviously, there are some run up values where they have the means to pay and they are still very vocal and they are not happy about it, but it is a tax on property value.

Councilmember Yukimura: Okay, thank you.

Committee Chair Kaneshiro: Any further questions from the Members on the presentation?

Councilmember Chock: Thank you for the presentation. It is real obvious why we should not be considering a cap and yet we are where we are because people are hurting. Outside of what you have been able to present here in this, are there further solutions that we should be looking at in terms of exemptions or other means of insuring that we can help people that we have not discussed? That is where I would like this discussion to go.

Mr. Hunt: I am not prepared to present anything today, but I think that is certainly something as we work through our workshops should consider is there another way. One that is in the front of my mind is rather than a tax cap maybe there is an assessment cap so that you still control rates if for some reason the growth of cost of government exceeds a CIP you can still raise the rate, but you cap the amount that the assessment can change year to year. For instance, you still valuing it market and that the market value goes from five hundred thousand (\$500,000) to seven hundred thousand dollars (\$700,000) in one year, but you have a five percent (5%) cap, you are limiting in five hundred twenty-five thousand as the maximum assessment. But I think if we are looking at that we might also want to consider a floor that when we have free falls where the values have tanked too, which puts pressure on raising tax rates. Therefore, maybe there are both a ceiling and a floor by which we should be looking at on capping an assessed value.

Councilmember Chock: I know we have said temporary before and it has not been, but I think the intent here is that this is a placeholder until we can have these discussions that I think are important that you are bringing up some

solutions towards. That being said, would the passing of this Bill have any implications to what it is that you are...

Mr. Hunt: Major operational implications. First is programing. We currently do not have the PHU program, it was on our legacy, the server version, and now we are on a web version so we would have to have a complete set of new programs come in to write code for the internet version. Again, we just got an estimate of what the permanent solution would be which could be an excess of a hundred thousand in programing. If we are having to explain again the cap taxes and all of that it may also involve additional personnel.

Councilmember Chock: Thank you.

Committee Chair Kaneshiro: We are going to take our lunch break and we will be back at 1:30. We have the presentation by the ICMA person that is scheduled for 1:30 because he has a flight to take, and then we will come back to our questions.

There being no objections, the Committee recessed at 12:29 p.m.

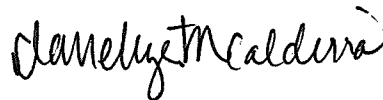
The meeting was called back to order at 6:38 p.m., and proceeded as follows:

Committee Chair Kaneshiro: We left off with what Mr. Hunt presented to us, we were asking questions on that, and we did not get any further than that. I would entertain a motion to defer.

Upon motion duly made by Councilmember Kualii, seconded by Councilmember Chock, and carried by a vote of 6:0:1 (*Councilmember Hooser was excused*), Bill No. 2606 was deferred.

There being no further business, the meeting was adjourned at 6:38 p.m.

Respectfully submitted,



Darrellyne M. Caldeira
Council Services Assistant II

APPROVED at the Committee Meeting held on January 21, 2016:



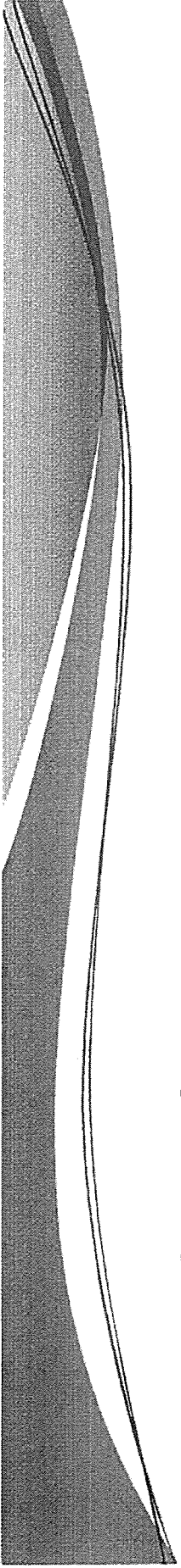
ARRYLO KANESHIRO
Chair, BF Committee

Reintroducing the Homeowner Tax Cap

County Of Kauai Finance Department

HISTORIC BACKGROUND

Real Property Taxes



Transfer of Real Property function from State to County was completed in 1982

- In 1981, the last year the State ran the real property functions, the tax rate was \$14.50 for all tax classes based on 60% of fair market value.
- When real property assessment was transferred to the Counties, the legislature prohibited the Counties from making ordinance changes for 10 years.
- In 1991, the Homestead tax class was created.

68 Ordinance Changes to Chapter 5A

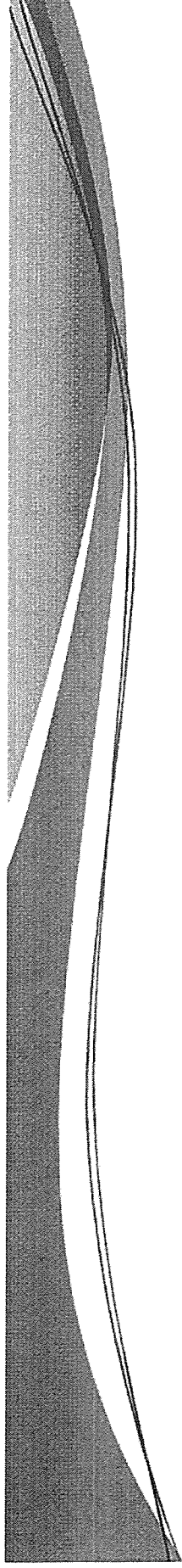
1990 – 571, 572, 573, 579, 582	2004 – 819, 820, 821, 822
1991 – 583, 584, 591, 596, 598, 600	2005 – 826, 833, 834, 835, 836
1992 – 603, 606	2007 – 862
1993 – 637, 645	2008 – 873
1994 – 637, 646, 658	2009 – 877, 889
1995 – 679, 680	2011 – 915, 916, 920
1996 – 705, 709, 713	2012 – 927, 932
1999 – 741, 742	2013 – 940, 953, 954
2000 – 755, 756	2014 – 966, 971, 972, 973, 976
2001 – 779, 780, 781, 782	977, 978, 980
2002 – 784, 789, 799, 800	2015 – 985, 995
2003 – 805, 806	

Tax Rate Changes over Time

- 1981 8 Tax Categories all paying the same tax rate of \$14.50 per \$1,000 of assessed value
- 1982 Increased Hotel & Resort to \$15.90 for land and improvements; decreased improvement rate on Residential, Commercial, and Agriculture to \$13.75
- 1983 Tax rates of \$8.70 for Land and \$8.25 for Improvements for 7 of 8 classifications; Single-Family Residential was reduced to \$7.70 for Land and \$7.66 for Improvements (but now based on 100% FMV)
- 1984 Reduced Single-Family Residential rate again, to \$6.45 for Land and \$5.81 for Improvements; all other rates stayed the same

Tax Rate Changes over Time (con't)

- 1991 Created new Homestead tax class and set tax rates at \$4.04 for the Land and \$3.18 for the Improvements*
- 2013 Developed a unified tax rate for land and improvements; started tax classification based on use; and Homestead tax rate is reduced to \$3.05*
- 2015 Have 10 tax classifications with large rate spreads ranging from \$3.05 to \$10.85; created Commercialized Home Use class for owner-occupied properties not exclusively used as primary residences*



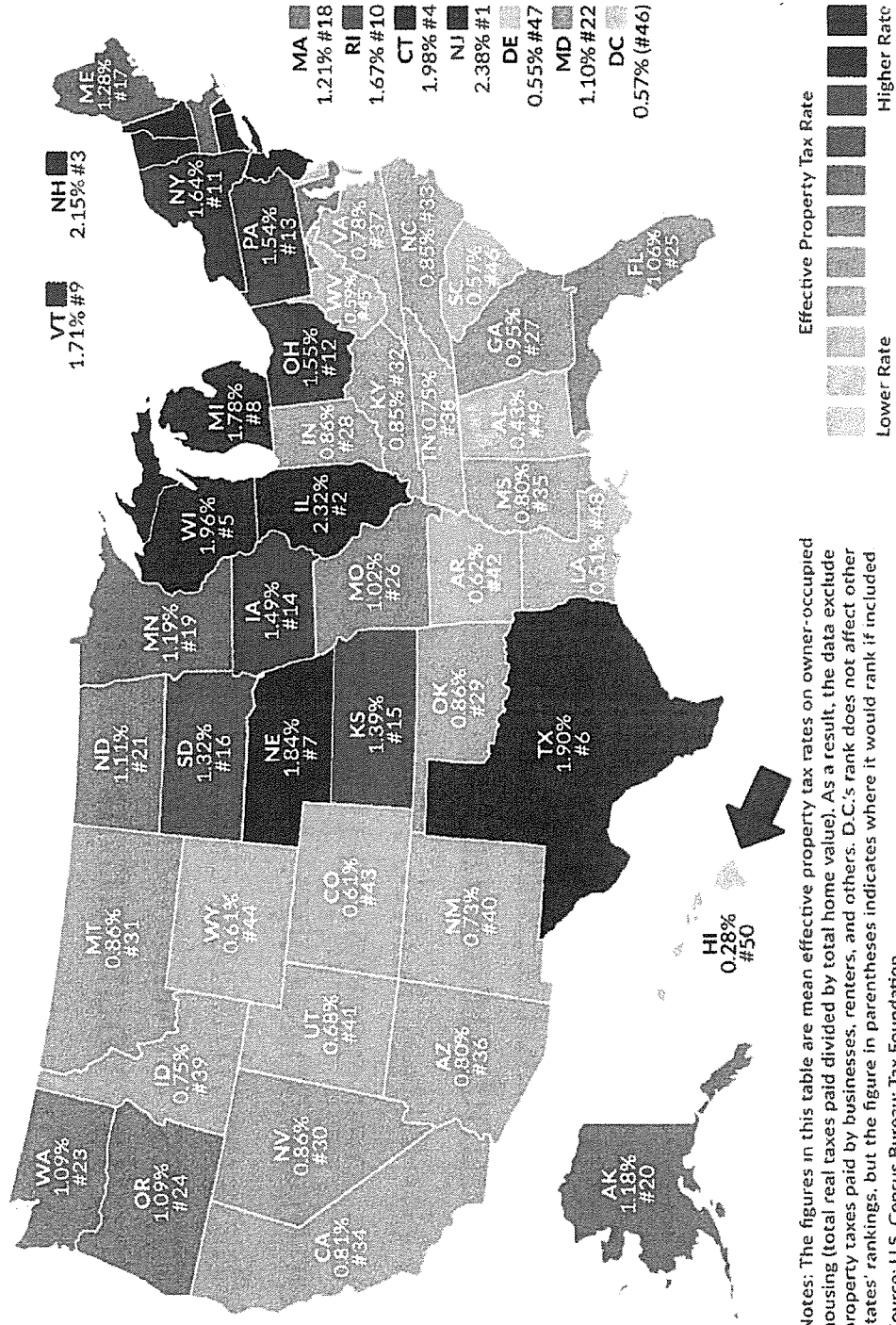
The Permanent Home Use Tax Cap

Why the Tax Cap was Removed

- Tax Cap was never intended to be a permanent solution but rather a temporary measure to allow tax reform proposals to be implemented (RPTTF & RPI)
- Needed to return to a more simplistic and understandable property tax system where taxes were once again related to property values
- Assure equity and fairness amongst taxpayers of a similar tax class, while providing sufficient income-based relief measures for those that have limited means

How High Are Property Taxes in Your State?

Mean Effective Property Tax Rates on Owner-Occupied Housing



Where Does Hawai'i's Property Taxes Rank?

- As the prior map illustrates, Hawai'i is last in terms of effective tax rates at \$2.80 per \$1,000 of assessed value (2015 Tax Foundation study).
- On the other hand, Hawai'i had the highest median values for owner-occupied properties at \$517,600 (2009 Tax Foundation study).
- When combining the highest assessments with the lowest tax rates, Hawai'i ranks 34th with a median tax of \$1,324 (2009 Tax Foundation study).
- Hawai'i has the 6th highest household income, and property taxes as a percentage of income ranked Hawai'i 41st, with median taxes being approximately 1.62% of household income (2009 Tax Foundation study).

Common Economic Criteria for Evaluating Tax Systems

- **Growth**—Does revenue raised by the tax grow along with the economy or the program responsibilities it is expected to fund?
- **Stability**—Is the revenue raised by the tax relatively stable over time?
- **Simplicity**—Is the tax simple and inexpensive for taxpayers to pay and for government to collect?
- **Neutrality**—Does the tax have little or no impact on people's decisions about how much to buy, sell, and invest?
- **Equity**—Do taxpayers with similar incomes pay similar amounts and do tax liabilities rise with income?

Growth:

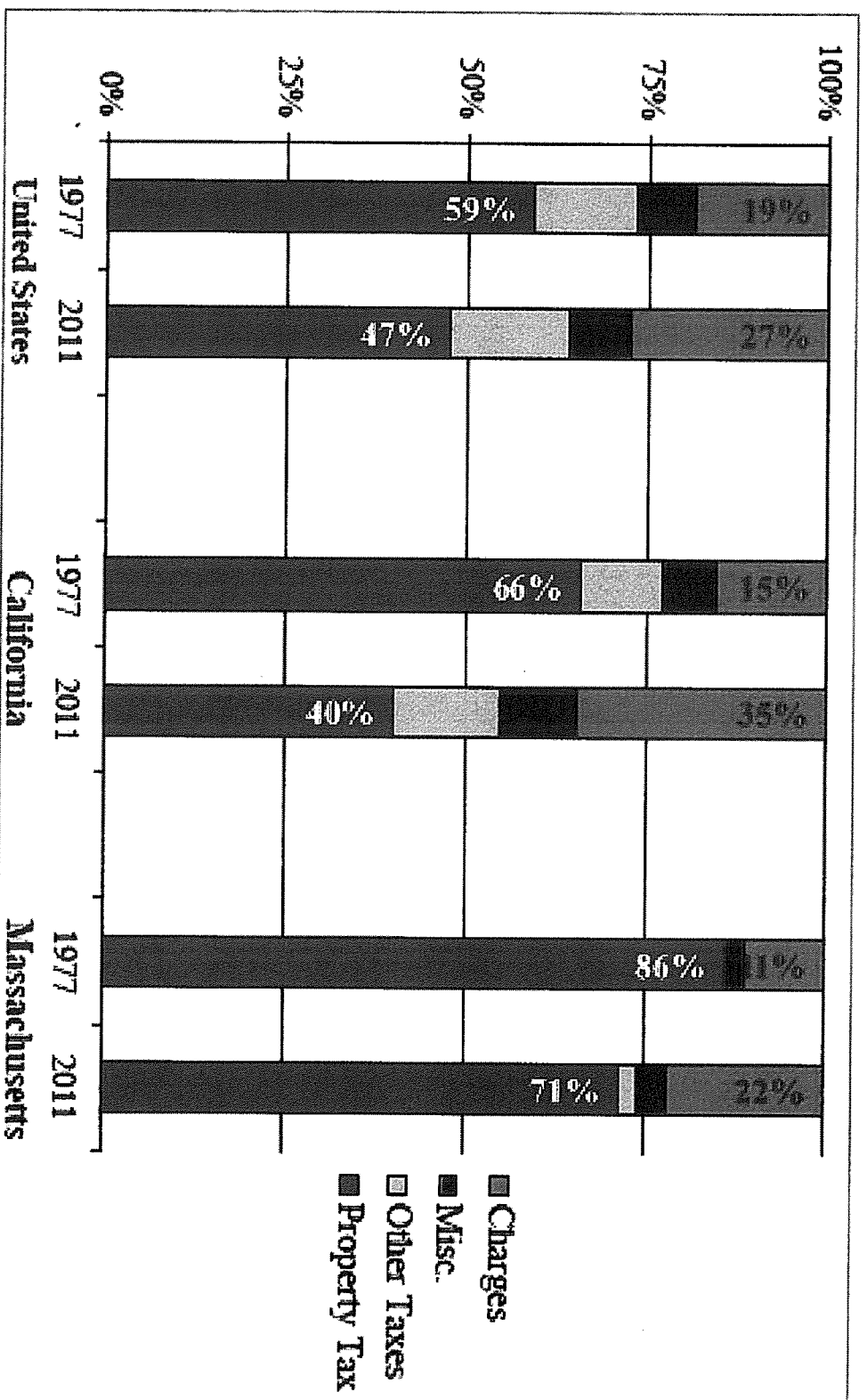
- Having capped taxes on nearly one-third (36.8%) of Kaua'i's gross valuation base that is solely affixed to the Consumer Price Index Urban (CPI-U) of Honolulu could severely limit the ability to meet obligations if or when expenses outpace this index.
- If the cost of employee wages (collective bargaining), health care premiums, County lawsuits, insurance premiums, road paving, existing and future debt service, solid waste disposal, recycling, transportation, gasoline, electricity, and emergency repair costs do not parallel the CPI-U of Honolulu, then the additional costs above and beyond the CPI-U index will have to be borne by the non-homeowner tax classes.



Growth:

- Property values generally increase as the economy grows, but they are not always proportionate to one another. Property values are affected by supply and demand, interest rates, and outside investment. Therefore, real estate values may rise and fall faster than other economic indicators.
- Similarly, the programs and responsibilities that property taxes are funding do not always rise and fall with economic indicators. The County cannot simply layoff civil servant employees when the economy dips as there are contractual agreements that must be honored.
- Under this proposed cap model, growth is limited to CPI-U unless these properties sell and the cap is reset.
- Municipalities using capped tax systems tend to see increased fees and other taxes, such as Community Facilities Districts (Mello-Roos) and service fees to offset periods when tax revenues are insufficient.

Local Government Own-Source Revenue



Source: U.S. Census Bureau, Annual Surveys of State and Local Government Finance.



Stability:

- Property values do change year-over-year, and they occasionally do so with significant swings based on market sales.
- Capping taxes provides homeowners with a certain level of predictability during a rising market, however it does not provide revenue stability for the County when values are falling. As currently written, this bill only provides homeowners with stability not the County of Kauaʻi.
- Under this proposed bill, if assessed values decline and the market taxes (*net taxable value x tax rate*) fall below the capped taxes, the actual taxes are lowered and a new cap ceiling is created. This would severely limit tax revenue during a market recovery.

Simplicity:

- While on the surface it may seem straightforward enough, take it from experience ... 10 years worth ... the tax cap is a highly complicated program to understand and implement.
- Aside from having to explain to taxpayers, lenders, and other interested parties how the taxes were calculated, there are other tax adjustments that need to be accounted for such as, additional construction, renovations, changes in exemptions, changes in tax classification, and land area changes (subdivisions, consolidations, and CPRs). Please consider that properties rarely remain stagnant over time.

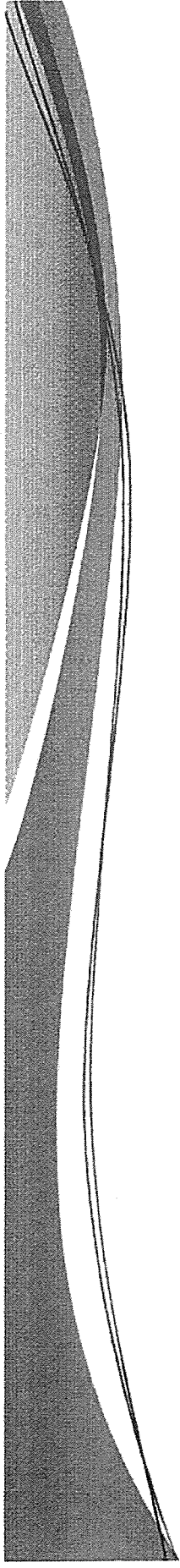


Simplicity:

- The percentage of time that RPA staff spent solely on PHU cap related issues was about 30%-35%. This significantly reduced the amount of time available for picking up new construction, enforcing tax code, and analyzing neighborhoods for better market modeling results.
- Returning to a capped tax system would require additional budgetary funding. Software customization, especially if this bill makes the cap permanent, may be in excess of \$100,000. RPA would also request additional staff to help manage the tax cap adjustments given the challenges it created in prior years.
- Administering a tax cap is anything but simple.

Neutrality:

- Having a tax cap could alter taxpayer behavior over time. For example, longtime homeowners that have accumulated sizable differences between their capped taxes and their market taxes may not be able to downsize without the portability of their property capped taxes.
- In turn, this not only affects the real estate market by possibly preventing certain inventory from being marketed, but it also limits potential revenue growth as turnover and the resetting of the cap are key elements to revenue growth under a capped tax model.
- Tax caps may also discourage investment in owner-occupied properties since new construction is fully taxed.



Equity:

- There are two standards of equity – vertical and horizontal – to evaluate taxes.
- Vertical equity occurs when wealthier taxpayers pay a greater amount in taxes than less wealthy taxpayers.
- Horizontal equity, on the other hand, occurs when similar taxpayers—those with similar incomes or wealth—pay the same amount in taxes.
- When two owners of nearly identical properties pay different amounts of property taxes because one owner bought the property a decade before the other, then no horizontal equity has been achieved.

Equity:

- With vertical equity, owners of valuable property would pay more in taxes because owners of valuable property generally are wealthier than owners of less valuable property.
- The capped tax system can result in owners of more valuable property paying less in property taxes than owners of (recently acquired) less valuable property.
- Tax caps do not meet the standards of either vertical or horizontal equity.

Doomed to Repeat History

- Reintroducing the tax cap will bring back many of the problems that existed, namely:

Unequal taxes between homeowners within the same tax class and having similar assessed values

Inability to recover revenue losses when market taxes fall below the prior year's capped ceiling amounts

Creates a disproportionate tax burden on other tax classes should the operating cost of government exceed the CPI-U of Honolulu

Given that this would be a revenue cap, it may limit future capital improvement investment

It does not allow for timely budget revenue forecasts

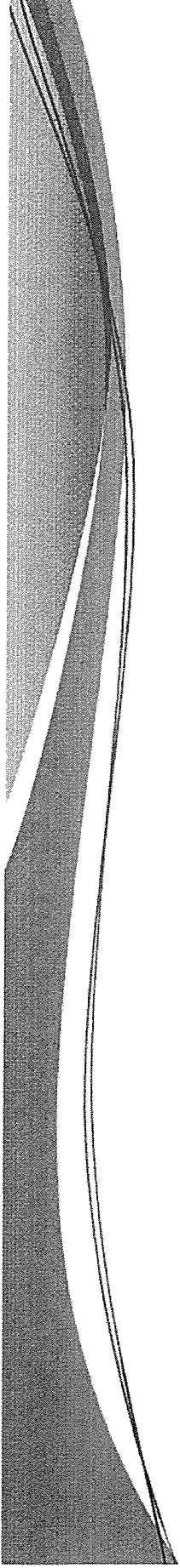
May Create Future Problems

- Reintroducing the tax cap could also create new problems, such as:

Cap may undermine many of the existing tax reform measures already enacted to minimize the impacts of the former PHU cap's removal

It may create a backlash with our state legislators, as County officials have been lobbying for a greater share of TAT monies based on our testimony that Kaua'i County has insufficient tax revenues

Limiting tax revenue could have possible bonding implications as rating agencies look at the ability to generate revenue in their analysis



Mahalo